

STATE OF ALABAMA  
DEPARTMENT OF INSURANCE  
MONTGOMERY, ALABAMA

REPORT ON EXAMINATION

OF

ALFA MUTUAL INSURANCE COMPANY

Montgomery, Alabama

AS OF

DECEMBER 31, 2006

Participation:

ALABAMA  
Southeastern Zone, NAIC

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**AFFIDAVIT**

**STATE OF ALABAMA  
COUNTY OF MONTGOMERY**

Blase Francis Abreo, being first duly sworn, upon his oath deposes and says:

THAT he is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of *ALFA MUTUAL INSURANCE COMPANY*, for the period of January 1, 2002 through December 31, 2006;

THAT the following 52 pages constitute the report therein to the Commissioner of Insurance of the State of Alabama; and

THAT the statements, exhibits, and data therein contained are true and correct to the best of his knowledge and belief.

Francis Blase Abreo  
Blase Francis Abreo, CFE

Subscribed and sworn to before the undersigned authority this 23<sup>rd</sup> day of May 2008.

Dianne B. Mills  
(Signature of Notary Public)

Dianne B. Mills Notary Public  
(Print Name)

in and for the State of Alabama

My Commission expires 4-18-2009



BOB RILEY  
GOVERNOR

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**DEPARTMENT OF INSURANCE**  
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CHIEF EXAMINER  
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Montgomery, Alabama  
May 23, 2008

Honorable Mary Jo Hudson  
Chairman, Examination Oversight Task force  
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Honorable Walter A. Bell  
Commissioner of Insurance  
Alabama Department of Insurance  
P. O. Box 303350  
Montgomery, Alabama 36130-3350

Dear Commissioners and Directors:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2006, has been made of

**ALFA MUTUAL INSURANCE COMPANY**

at its home office at 2108 East South Boulevard, Montgomery, Alabama, 36116. The report of examination is submitted herewith. Where the description "Company" appears herein, without qualification, it will be understood to indicate Alfa Mutual Insurance Company.

## SCOPE OF EXAMINATION

A full scope financial and market conduct examination was authorized pursuant to the instructions of the Alabama Insurance Commissioner and in accordance with the statutory requirements of the *Alabama Insurance Code* and the regulations and bulletins of the State of Alabama Department of Insurance in accordance with the applicable guidelines and procedures promulgated by the National Association of Insurance Commissioners (NAIC); and in accordance with generally accepted examination standards.

The Company was last examined for the four-year period ended December 31, 2001. A limited scope examination for the period ended December 31, 2004, concluded on July 20, 2005. The current examination covers the intervening period from January 1, 2002, through December 31, 2006, and was conducted by examiners from the Alabama Department of Insurance. Where deemed appropriate, transactions subsequent to December 31, 2006, were reviewed.

The examination included a general review of the Company's operations, administrative practices, and compliance with statutes and regulations. Corporate records were inspected. Income and disbursement items for selected periods were tested. Assets were verified and valued, and all known liabilities were established or estimated as of December 31, 2006. However, the discussion of assets and liabilities contained in this report has been confined to those items which resulted in a change to the financial statements, or which indicated a violation of the *Alabama Insurance Code* and the Insurance Department's rules and regulations, or other insurance laws or rules, or which were deemed by the examiner to require comments and/or recommendations.

The Company copies of the filed Annual Statements for the years 2002 through 2006 were compared with or reconciled to account balances with respect to ledger items.

The market conduct phase of the examination consisted of a review of the Company's territory, plan of operation, complaint handling, marketing and sales, producer licensing, policyholder service, underwriting and rating, claims payments and practices, and compliance with privacy policies and practices.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attests to having valid title to all assets and to the non-existence of unrecorded liabilities as of December 31, 2006. A signed letter of representation was also obtained at the conclusion of the examination

whereby management represented that, through the date of this examination report, complete disclosure was made to the examiners regarding asset and liability valuation, the financial position of the Company, and contingent liabilities.

## **ORGANIZATION AND HISTORY**

The Company was incorporated August 13, 1947, under the name, Alabama Farm Bureau Mutual Casualty Insurance Company. It was organized as a mutual insurance company by the Alabama Farm Bureau Federation (AFBF), to provide property and casualty insurance to the members of the AFBF.

Effective May 1, 1987, AFBF withdrew, as a franchise member, from the national Farm Bureau Federation and changed its name to Alabama Farmers Federation. The name of the Company was changed to Alfa Mutual Insurance Company.

During the interim from the Company's organization through 1987, the Company became affiliated with four other property and casualty insurers. In 1987, a reinsurance pooling agreement was formed between these five affiliates. The terms of the agreement provide that all direct business of the affiliates will be ceded to the Company. The pooled business is then retroceded according to percentages provided in the pooling agreement. In 1989, an intercompany reinsurance pooling committee, representing the boards of directors of the reinsurance pool participants, was established. This committee is responsible for reviewing and approving any changes to the pooling agreement, to assure that transactions are fair and equitable to all pool participants, and to monitor potential, or actual, conflicts of interest between pool participants.

In 1999, Alfa Specialty Insurance Corporation (ASI) was organized as a wholly-owned subsidiary of the Company. ASI became a participant in the reinsurance pooling agreement in 2001.

In 2004, Alfa Vision Insurance Corporation (AVI) was organized as a wholly-owned subsidiary of Alfa Corporation, an SEC registrant. Alfa Corporation is affiliated with Alfa Mutual Insurance Company, Alfa Mutual Fire Insurance Company, and Alfa Mutual General Insurance Company (collectively, the Mutual Group). The Mutual Group owns 54.8% of Alfa Corporation's common stock, their largest single investment. (See the heading SUBSEQUENT EVENTS for development on Alfa Corporation). AVI commenced business on January 1, 2005, and became a participant in the reinsurance pooling agreement effective January 1, 2005.

During the period covered by the examination, the Company amended the Articles of Incorporation by adding ARTICLE VIII, which was effective April 24, 2003, and amended Section II of the *By-Laws*, which was effective September 25, 2006.

## MANAGEMENT AND CONTROL

### Policyholders

The Company is a mutual insurance corporation with ownership vested in its policyholders. Membership in the Alabama Farmers Federation is a prerequisite for the purchase of insurance from the Company.

### Board of Directors

According to Section III of the *By-Laws*, the corporate powers of the Company shall be vested in a Board of Directors consisting of eighteen directors. Directors are elected at the annual meeting and serve until their successors are elected and qualified. The following directors were serving at December 31, 2006:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Jerry Allen Newby Athens, Alabama	Chairman of the Board, President and CEO, Alfa Mutual Insurance Company
Jacob Calhoun Harper Camden, Alabama	Vice President, Southwest Area, Alfa Mutual Insurance Company
Richard Earl Saxon Attalla, Alabama	Farmer
David Eugene Bitto Elberta, Alabama	Farmer
Hal Franklin Lee Hartselle, Alabama	Vice President, North Area, Alfa Mutual Insurance Company
Stephen Leonard Dunn Evergreen, Alabama	Treasurer, Alfa Mutual Insurance Company
Luther Olen Bishop, Jr. Cherokee, Alabama	Farmer
William Larry King Guntersville, Alabama	Farmer
James Leo Allen Lisman, Alabama	Farmer



Jerry Houston Byrd Ariton, Alabama	Farmer
Russell Riley Wiggins Andalusia, Alabama	Vice President, Southeast Area, Alfa Mutual Insurance Company
John Guy Neighbors Alex City, Alabama	Farmer
John Elijah Walker Berry, Alabama	Farmer
James Louis Parnell Stanton, Alabama	Farmer
Curtis Dean Wysner Woodland, Alabama	Vice President, Central Area, Alfa Mutual Insurance Company
Stanley Ray Usery Athens, Alabama	Farmer
Doyle Leon Phillips Delta, Alabama	Farmer
Michael Wayne Dunn Union Springs, Alabama	Farmer

### **Officers**

The Company's *By-Laws* provide that its principal officers shall be a Chairman of the Board, President, four Vice Presidents, a Secretary, a Treasurer, and, such other officers as the Board of Directors may determine for such terms, authority and duties as may be determined by the Board of Directors. Any two or more offices may be held by the same person, except the offices of President and Secretary. One person may serve as both the Chairman of the Board and President.

The following officers were elected by the Board of Directors and were serving at December 31, 2006:

<b>Officer</b>	<b>Title</b>
Jerry Allen Newby	Chairman of the Board, President and CEO
Stephen Leonard Dunn	Treasurer
Herman Alan Scott	Secretary
Clyde Lee Ellis III	Assistant Treasurer
Russell Riley Wiggins	Vice President, Southeast Area
Curtis Dean Wysner	Vice President, Central Area
Jacob Calhoun Harper	Vice President, Southwest Area
Hal Franklin Lee	Vice President, North Area

The following were appointed officers at December 31, 2006:

Officer	Title
Clyde Lee Ellis III	Executive Vice President, Operations
Herman Tyrone Watts	Executive Vice President, Marketing
Stephen Goddard Rutledge	Senior Vice President, CFO & Chief Investment Officer
Herman Alan Scott	Senior Vice President and General Counsel
James Rogers Azar	Senior Vice President, Audit & Risk Management
John Thomas Jung	Senior Vice President, Chief Information Officer
Jerry William Johnson	Senior Vice President, Claims
Thomas Earle Bryant	Senior Vice President, Human Resources
Wyman Worley Cabaniss	Senior Vice President, P & C Underwriting
William Bradley Harper, Jr.	Senior Vice President, Life & Loan Operations
John Charles Russell	Senior Vice President, Vision Insurance
Jerry Charles Ralph	Senior Vice President, Marketing, North Alabama
William Merit Hardy, Jr.	Senior Vice President, Marketing, South Alabama
Carol Lynn Golsan	Senior Vice President, Marketing Services
Darrell Lee McNeal	Vice President, Georgia Marketing
Robert Wyatt Pace	Vice President, Mississippi Marketing
Douglas Stephen Joyce	Vice President, Virginia Mutual
Alfred Edwin Schellhorn	Vice President, Corporate Development
Linda Gail Pelt	Vice President, Auto Underwriting
Mark Clayton Campbell	Vice President, Facilities
Kevin Scott Lawrence	Vice President, Office Systems
Mona Thompson Russell	VP, Policy Processing
Harold Ray Mann	Vice President, Programming Systems
Kenneth Everett Stephens	Vice President, P & C Systems Implementation
Elizabeth Vail Chancey	Vice President, Property & Casualty Underwriting
Ralph Clayton Forsythe	Vice President, Finance & Assistant CFO
David Ray Proctor	Vice President, Taxes
Gordon Thomas Carter	Vice President and Associate General Counsel
Walter Leonard Overby	Vice President, Data Processing
Hudson Clayton Bush, Jr.	Vice President, Alfa Agency/ASIC
Thomas Allen Foster	Vice President, Loan Operations
Kerry Horner Lashlee*	Vice President, Life Underwriting & Policy Owner Service
Donald Eugene Manis	Vice President, Property & Casualty Actuary
Kenneth Leonard Nelson**	Vice President, Life Actuary

Christine Gnann Cantrell	Vice President, Marketing Communications
Dominic Charles Labriola	Vice President, Advanced Sales
Joseph Lawrence Reese, Jr.	Vice President, IS Technical Planning
Jesse Eddy Mills III	Vice President, IS Technical Support
Robert Ernest Robinson	Vice President, Business Systems Development
Michael Stephen Morris	Vice President, Research and P&C Compliance
William Scott Forrest	Vice President, Compensation, Benefits and HRIS
Connie Leah Whitecotton	Vice President, Chief Risk & Compliance Officer
Jacob Daniel Black	Vice President, P&C Accounting
Patti Jo Everage	Vice President, Financial Reporting & Planning
Russell John Sinco	Vice President, Projects, Finance
Cheryl Theresa Mitchell	Assistant Vice President & Assistant Secretary
Julie Meadows Parish	Assistant Vice President, Fin. Reporting Compliance
Tammy Lynn Hackett	Assistant Vice President, Life & Investment Accounting
Michael Wayne Rowell	Assistant Vice President, Corp. Development
George Clifford Crosby	Assistant Vice President, Life Actuary
David Eric Swedenburg	Assistant Vice President, Life Underwriting
Douglas Wade Simpson	Regional Vice President, Claims
Harold Eugene Oakes	Regional Vice President, Claims
John Delane Hemmings, Jr.	Vice President, Investments

\*Retired: December 1, 2007

\*\*Retired: March 1, 2008

### Committees

The following committees were appointed by the Board of Directors and were serving at December 31, 2006:

<u>Executive Committee</u>	
Jerry Allen Newby	Curtis Dean Wysner
Hal Franklin Lee	Jacob Calhoun Harper
Russell Riley Wiggins	Stephen Leonard Dunn
<u>Compensation Committee</u>	
Hal Franklin Lee	Jacob Calhoun Harper
Russell Riley Wiggins	Stephen Leonard Dunn
Curtis Dean Wysner	Jerry Allen Newby

<u>Contribution Committee</u>	
Hal Franklin Lee	Russell Riley Wiggins
Jacob Calhoun Harper	Curtis Dean Wysner
Stephen Leonard Dunn	
<u>Pooling Committee</u>	
Jerry Allen Newby	John Elijah Walker
David Eugene Bitto	

### Conflict of Interest

The Company follows an established procedure for the disclosure of conflicts between the Company's interest and the personal interest of directors and officers. The conflict of interest policy is part of the "Principles of Business Conduct" (Principles) policy, which was effective August 14, 2001. Effective February 4, 2003, the Principles went into major revision, when the Company incorporated the provisions required by the Federal Sarbanes-Oxley Act.

Section 8 of the revised Principles, does not require the employees to sign annual conflict of interest statements. Under the policy, all new employees are required to confirm their compliance with the policy at their hiring. Confirmations are obtained from all existing employees when the policy undergoes significant revision, or whenever circumstances dictate that reconfirmation would be helpful in reinforcing the Company's "tone at the top" message.

The listing that indicated that the officers and directors had read the Principles and electronically acknowledged that they had read the Principles was reviewed. The disclosures made during the period did not appear to represent a conflict of interest. The listing was checked with the names of the officers and directors listed on the Company's Annual Statements under examination. The review indicated that some directors and some elected officers, all of which were non-employees, had not acknowledged reading the Principles, since it had a significant revision, effective February 4, 2003. Company management indicated that the aforementioned directors and elected officers had signed the acknowledgement, confirming reading and adhering to the Principles, since its significant revision. However, according to Company management, the signed copies had been misplaced and could not be located.

The Company indicated "Yes" to the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions, which asks the following question:

“Has the reporting entity an established procedure for disclosure to its board of directors or trustees of any material interest or affiliation on the part of any of its officers, directors, trustees, or responsible employees that is in conflict or likely to conflict with the official duties of such persons?”

As noted above, the Company had an established procedure for the disclosure of conflicts of interest to the Board of Directors; however, the Company could not provide evidence that all directors and officers had signed the conflict of interest statements.

## **CORPORATE RECORDS**

The Articles of Incorporation and *By-Laws*, as amended were inspected and found to provide for the operation of the Company in accordance with usual corporate and applicable statutes and regulations. During the period covered by the examination, the Company amended the Articles of Incorporation by adding ARTICLE VIII, which was effective April 24, 2003, and amended Section II of the *By-Laws*, which was effective September 25, 2006.

Minutes of the Annual Membership meetings, Board of Directors, and committees from January 1, 2002, through December 31, 2007, recorded by the Company were reviewed. The minutes appeared to be complete with regard to recorded actions taken on matters before the respective bodies for deliberation and action.

## **HOLDING COMPANY AND AFFILIATES**

### **Holding Company Registration and Reporting**

The Company is subject to the *Alabama Insurance Holding Company Regulatory Act*, as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as joint registrant of an Insurance Holding Company System. The Company is responsible for holding company registration and periodic filings in accordance with ALA. CODE § 27-29-4 (1975), and ALA. ADMIN. CODE 482-1-055 (1994).

Appropriate filings required under the Holding Company Act were made from time to time by the Company as registrant. The examination determined that the Company did not make all of the necessary filings as required by ALA. CODE § 27-

29-5 (1975). The filings did not include FORM B filings for the capital contributions listed below or a FORM D filing as discussed under the caption *Monthly Billing Service Agreement*.

Below are capital contributions that were not included in the FORM B filings:

- Capital contribution of \$2,117,500 made by Alfa Corporation to Alfa Vision Insurance Company during the year 2004.
- Capital contribution of \$15,000,000 made by Alfa Corporation to Alfa Vision Insurance Company during the year 2005.
- Capital contribution of \$20,000,000 made by Alfa Corporation to Alfa Vision Insurance Company during the year 2006.

ALA. ADMIN. CODE 482-1-055 (1994), states:

“Form B – Item 5. Transactions and Agreements

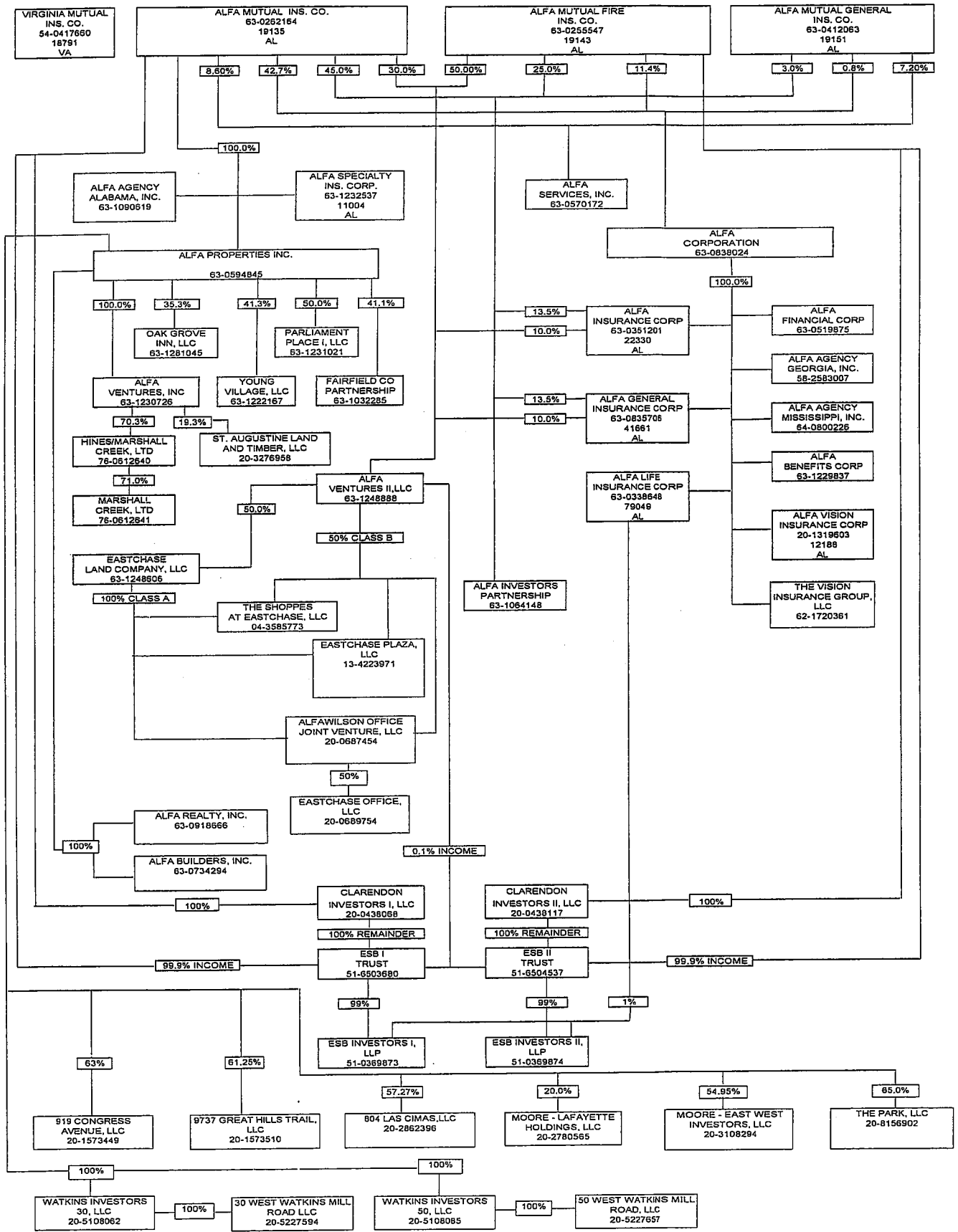
Briefly describe the following agreements in force, and transactions currently outstanding or which have occurred during the last calendar year between the registrant and its affiliates. . . (a) Loans, other investments, or purchases, sales or exchanges of securities of the affiliates by the Registrant or of the Registrant by its affiliates. . . .”

Capital contributions made by Alfa Corporation to Alfa Vision Insurance Corporation are considered “other investments;” hence, the transaction should have been reported in the annual Form B filings and within 15 days from the end of the month in which the material change to the annual registration had taken place. Hence, the Company also did not comply with ALA. ADMIN. CODE 482-1-055-.15 (1) (1994), which states:

“An Amendment to Form B shall be filed within fifteen (15) days after the end of any month in which there is a material change to the information provided in the annual registration statement.”

### Organizational Chart

The Chart on the following page depicts the insurance company system with which the Company was affiliated as of December 31, 2006.



## Transactions and Agreements with Affiliates

### *Management and Operating Agreement.*

The following insurers were under the control of the Company and were parties to a Management and Operating Agreement with it: 1) Alfa Mutual Fire Insurance Company; 2) Alfa Mutual General Insurance Company; 3) Alfa Life Insurance Corporation; 4) Alfa Insurance Corporation; 5) Alfa General Insurance Corporation; 6) Alfa Specialty Insurance Corporation; and 7) Alfa Vision Insurance Corporation. These companies will be referred to, collectively, as the “affiliates” in the remainder of the discussion of this topic.

The original agreement had been in effect since January 1, 1960, with periodic amendments to modify the terms and to add companies as they became affiliated. Effective January 1, 2001, it was amended and restated “. . . in its entirety in order to clarify and make more certain their relationship to one another.” Also, the term of the agreement was to be five years, through December 31, 2005, then automatically renewed for periods of one year. Effective January 1, 2005, it was amended to include Alfa Vision Insurance Corporation.

Pertinent terms of the agreement include the following:

- The affiliates appoint and engage the Company to take charge of, conduct, operate and manage the business operations of the affiliates, respective to each affiliate’s charter and Board of Directors, and in a proper and prudent fashion. The Company will provide all home office operating service to the affiliates, including accounting, disbursement and payroll services and will serve as a disbursing agent for the payment of all employees and agents of the affiliates.
- The Company agrees to employ, in its own name, all personnel necessary to perform the aforesaid, and reserves all rights and responsibilities of the employer of said personnel. All agents of the affiliates shall be appointed in the name of the respective affiliates and shall work on behalf of the respective affiliates. All personnel and agents of any affiliate employed outside Alabama are the sole responsibility of that affiliate. The Company also agrees to indemnify and hold the affiliates harmless against any loss on account of the dishonesty or infidelity of any of the Company’s employees. Also, the affiliates agree to indemnify and hold harmless the Company for liabilities and obligations prior to the effective date of the agreement, failure or negligent failure of the affiliate to perform under the



agreement, breach of warranty by the affiliate and liabilities or obligations of the Company's management or operation of the affiliate.

- The Company agrees that the business of each party to the agreement shall be conducted in the name of the respective party and that the records of each party shall be kept separately. The Company agrees to provide all required records, record-keeping services and data processing necessary to the efficient and economical operation of such business.
- The affiliates agree to reimburse the Company for expenses and additional charges in accordance with schedules which are attached to the agreement. These schedules are subject to periodic amendment. Expense allocations and other charges are determined by time, usage, and related special expense allocation studies conducted by the Company. Expenses entirely attributable to the affiliates such as printing and supplies are purchased and paid for directly by the respective affiliate.
- Arbitration: Disputes not resolved in 30 days are to be submitted for arbitration in the Birmingham, Alabama, office of the American Arbitration Association in accordance with commercial arbitration rules.
- Confidentiality: Each party agrees to keep all Confidential Information strictly confidential.

Numerous expense categories are prorated between affiliates on Schedule A, an attachment to the agreement. Certain other expenses are allocated directly to the affiliates that benefit from expenditures. Agents' commissions are allocated 100% to the affiliate writing the business. Fixed monthly charges are paid by the affiliate for certain other expenses.

### ***Tax Allocation Agreement***

The Company entered into a Tax Allocation Agreement between AMI (the Company/Parent) and among affiliates including Alfa Specialty Insurance Corporation, Southern Boulevard Corporation, Alfa Agency Alabama, Inc. and Alfa Ventures, Inc. on January 1, 2004, which applied to the taxable year ending December 31, 2003, and subsequent years until terminated. The agreement was amended and restated effective March 1, 2004, to add affiliates Alfa Builders, Inc. and Alfa Realty, Inc. to the affiliated group. The agreement was amended and restated

again on May 22, 2006, to change the tax allocation method to the percentage method pursuant to Treasury Regulation §1.1502-33(d)(3).

The Company and affiliates, parties to the agreement, agree as follows:

- A U.S. consolidated income tax return shall be filed by the Parent for the taxable year ending December 31, 2006, and for each subsequent taxable period in respect of which this agreement is in effect and for which the affiliated group is required or permitted to file a consolidated tax return.
- The agreement stipulates that the tax liability of the group shall be apportioned among the members of the group in accordance with the ratio of that portion of the consolidated taxable income attributable to each member of the group, and that each bears to the consolidated taxable income.
- The parties to the agreement agreed that the consolidated tax liability for each year, determined in accordance with Treasury Regulation §1.1502-2, shall be apportioned among them in accordance with the provisions of Treasury Regulation §1.1502-33(d)(3) (Percentage Method). This percentage method allocates tax liability based upon the absorption of tax attributes, without taking into account the ability of any member to subsequently absorb its own tax attributes.
- Payment of the consolidated tax liability for a taxable period shall include the payment of estimated tax installments due for such taxable period, and each subsidiary shall pay to the Parent its share of each payment within ten days of receiving notice of such payment. Any amounts paid by a subsidiary on account of a separate return or separate estimated tax payments which are credited against the consolidated tax liability of the Affiliated Group, shall be included in determining the payments due from such subsidiary. Any overpayment of estimated tax should be returned to the subsidiary.
- If the consolidated tax liability is adjusted for any taxable period, whether by means of an amended return, claim for refund, or after a tax audit by the IRS, the liability of each member shall be recomputed to give effect to such adjustments, and in the case of a refund, the Parent shall make payment to each member for its share of the refund, within ten days after the refund is received by the Parent. In the case of an increase in tax liability, each member shall pay to the Parent its allocable share of such increased liability within ten days after receiving notice of the liability from the Parent.

- If, during a consolidated return period, the Parent or any subsidiary acquires or organizes another corporation that is required to be included in the consolidated return, then such corporation shall join in and be bound by the agreement. The agreement shall be binding upon and inure to the benefit of any successor, whether by statutory merger, acquisition of assets or otherwise, to any of the parties, to the same extent as if the successor had been an original party to the agreement.

### *Monthly Billing Service Agreement*

The Company entered into a Monthly Billing Service Agreement between Alfa Financial Corporation (Financial) and: 1) The Company, 2) Alfa Mutual General Insurance Company, 3) Alfa Mutual Fire Insurance Company, 4) Alfa Insurance Corporation, and 5) Alfa General Insurance Corporation (collectively referred to as "Insurers"). The agreement was effective January 1, 2005, and included the following:

- Financial agreed to grant a perpetual nontransferable license to use Financial's software in order to process transactions.
- Insurers will pay to Financial a non-refundable processing fee for the right to use Financial's software for processing monthly premium payment transactions.
- Financial will bear all credit losses.
- Financial shall be obligated to provide the software to Insurers without further charge or obligation and to provide Insurers any and all updates to said software.
- Insurers will remit to Financial the service fees no less frequently than on a monthly basis.
- The contract may be cancelled by either party by giving to the other party notice of cancellation in writing thirty days prior to the date cancellation is to become effective.
- In the event of cancellation, Insurers have no further right to use Financial's software, and Insurer's shall pay Financial through the date of cancellation.
- The contract will be governed by Alabama Law.

- The contract can only be amended in writing signed by all the parties.

A review of the aforementioned *Monthly Billing Service Agreement* and the holding company filings and amendments made on behalf of the Company indicated that the agreement had not been approved by the Alabama Department of Insurance. Because the Company had not obtained approval of the agreement among affiliates within the holding company system, the Company was not in compliance with ALA. CODE § 27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. . . .

(4) All management agreements, service contracts, and all cost-sharing arrangements; and. . . .”

## **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2006, the Company was named insured under a financial institution bond issued by Fidelity and Deposit Company of Baltimore, Maryland. The single loss limit of the bond met the NAIC suggested minimum requirements for fidelity coverage. The bond provided the following coverages:

- Fidelity
- Forgery or alteration
- Optional
  - Agents # 1
  - Computer systems fraud.

The Fidelity coverage insured the Company against any loss through any dishonest or fraudulent act committed by an employee acting alone or in collusion with others. The dishonest or fraudulent acts must be committed by the employee with the manifest intent to cause the insured to sustain such loss and to obtain financial benefit in the normal course of employment.

In addition to the fidelity bond, the Company maintained the following coverages to protect the Company against hazards to which it may be exposed:

- Management Liability
- Excess Directors' & Officers' Liability
- Excess Professional Liability
- Employment Practices Liability
- Fiduciary Responsibility Liability
- General Liability
- Property Liability
- Commercial Auto Liability
- Aviation Liability
- Commercial Umbrella Liability
- Workers' Compensation Liability
- Excess Workers' Compensation Liability

The types of coverages and the maximum limits indicated for each occurrence appear to have been sufficient to cover the Company from the liabilities arising from employees' injuries and other hazards to which it might be exposed. The insurance policies purchased by the Company to protect it and its affiliates did not name the affiliated companies as named insured; however, the Company indicated that its Risk Management Department has contacted the insurer and requested the affiliated companies be included as named insured on the insurance policies.

## **EMPLOYEES' AND AGENTS' WELFARE**

The Company is the employing entity for its seven insurance company affiliates, by means of the Management and Operating Agreement previously discussed under the caption, "Holding Company and Affiliates." Benefits are provided by the Company and costs are allocated to the affiliates in accordance with said agreement. The following benefits were provided to employees and agents during the examination period:

- Alfa Flex Plan: Health Insurance, Dental Insurance, Supplemental Cancer Insurance, Vision Insurance, Group Life Insurance, Long Term Disability Insurance, Accidental Death and Dismemberment Insurance, Health Care Spending Account, and Dependent Care Spending Account
- Employee Stock Purchase Plan

- Employee Savings Program
- College Savings Plan
- Defined Benefit Pension Plan
- Death Benefit Only Plan
- Supplemental Life Plan (Federation Employees Only)
- 401(K) Savings and Profit Sharing Plan
- Paid Holidays
- Paid Time Off (PTO)
- Short Term Disability
- Leave of Absence (PTO or unpaid)
- Family Medical Leave Act (PTO or unpaid)
- Jury Duty (PTO or unpaid)
- Military Leave (PTO or unpaid)
- Voting Time (PTO)

Benefits provided by the Company appeared to be in accordance with usual and customary practices within the insurance industry.

### **Death Benefit Only Plan**

All full time employees over the age of 21, having at least one year of service are eligible to participate in the DBO plan. Company management indicated that if a participant dies while employed, and if the Plan is in-force, and the benefits have not terminated, the Company will pay a death benefit from the general assets of the Company. The benefit payment is 100 times the projected normal monthly retirement benefit offset by the actuarial present value, grossed up for anticipated income taxes to be paid by the employee's estate. If the employee dies after 65, the benefit is reduced by 10% each year until the benefit is 50% at age 70.

The examiners determined that the Company purchases a universal life insurance policy on the life of each participant, from Alfa Life Insurance Corporation (Life). The Company is the applicant, owner and beneficiary of the policy. The Company pays the entire premium. The Company has the right to terminate the plan or the universal life policies at any time and for any reason. If the employee dies, the Company is paid the life insurance proceeds as beneficiary. Then, the Company pays the supplemental death benefit to the employee's beneficiary as described above.

The cash value of life insurance policies where the reporting entity is the owner and beneficiary is similar to a cash deposit that is realizable on demand. As such, the cash

value of a life insurance policy as of the date to which premiums have been paid is reported as an admitted asset. At December 31, 2006, the Company's Annual Statement showed \$169,696,000 in cash surrender value on the universal life insurance policies.

The examination determined that there was no liability recorded by the Company at December 31, 2006. Company management's interpretation is that the DBO Plan puts the specified event at death; therefore, a liability would not need to be set up until the death of the employee. In addition, the Company has the right to amend or terminate the DBO Plan at any time.

### **Section 1033 of Title 18 of the U.S. CODE**

The Company was asked how it determined if prospective and current employees and agents were not in conflict with Section 1033 of Title 18 of the U.S. Code, and ALA. ADMIN. CODE 482-1-121 (2003), which prohibits certain persons from participating in the business of insurance.

The Company provided an employment application used during the examination period which asks potential employees about any criminal convictions during the previous ten years and the authorization to obtain consumer and/or investigative consumer reports on the applicant. Company management indicated that the Company does not hire applicants who have been convicted of a felony unless prior authorization has been obtained from the Alabama Department of Insurance in accordance with ALA. ADMIN. CODE 482-1-121 (2003). The Company's "Principles of Business Conduct" (Principles) policy requires that employees report any felony convictions, either personal or about another employee immediately to Human Resources.

Although, the employment applications used during the examination period, asked potential employees about felony convictions within the last ten years, and the Principles policy requires employees to report felony convictions, the Company could not demonstrate that employees who had been with the Company before the Principles went into effect were not in conflict with ALA. ADMIN. CODE 482-1-121 (2003), which states:

"... The Act contains no grandfather provision for persons already transacting the business of insurance. The Act contains no automatic waivers for individuals who may possess a state insurance license. Further, there is no

time limitation on how far back the felony conviction that triggers the prohibited person status may have occurred. . . .”

The Company indicated it had a procedure in place to perform background checks on agents and customer service representatives since 1998, and on its home office employees since 2004. The Company provided evidence that in 2003-2004 its employees electronically certified pursuant to the Company’s Principles policy that they had not been convicted of a felony and would inform management of any changes to their responses. According to the Company, employees hired subsequent to 2004 signed the policy when hired and a copy is maintained in their personnel file.

The Company could not provide evidence that it had a policy in place to ensure those authorized to act on its behalf continue to meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

“ . . . Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred. . . .”

## **MARKET CONDUCT ACTIVITIES**

### **Territory**

Schedule T – Exhibit of Premiums Written of the December 31, 2006, Annual Statement indicated that the Company was licensed to do business in the following States:

Alabama	Indiana	New York	South Carolina
Connecticut	Kentucky	North Carolina	Tennessee*
Georgia	Massachusetts	Ohio	Virginia
Illinois	Michigan	Pennsylvania	Wisconsin

The Certificates of Authority were inspected for the period under review. The Company could not provide the Certificate of Authority to do business in the state of Tennessee. Company management indicated that the Company did not have a



license in the State of Tennessee. The examination determined that *Schedule T* was not appropriately completed.

### **Plan of Operation**

The Company markets its products through captive agents. At December 31, 2006, the Company had 262 service centers in Alabama, with 486 agents appointed to write its business. The Company did not write business outside of Alabama during the examination period, although it was licensed in fourteen other states.

For the year 2006, direct premiums written for private passenger automobile comprised about 58% of the Company's total business. Another 44% was comprised of homeowner, farmowner and commercial insurance. The remaining 1% was divided among other lines of business.

The Company did not disclose any plans for acquisitions or expansions in the future.

### **Policy Forms and Underwriting Practices**

The Company's active policy forms and rates in force at December 31, 2006, which were reviewed, were found to have been approved by the Alabama Department of Insurance.

The Company filed its rates independently for its automobile, homeowner and farmowner business.

Membership in the Alabama Farmers Federation was a prerequisite to the issuance of a policy with the Company. The Company's policy is to cancel coverage when Federation membership is not renewed, except on those policies involving a real property lien holder.

### **Compliance with Agents' Licensing Requirements**

In order to verify compliance with agents' licensing requirements of the Alabama Department of Insurance (ALDOI), a sample of fifty agents licensed in Alabama was taken from the listing maintained by the Company. The agents' names were compared with the listing maintained on the ALDOI website. No discrepancies were found within the sample.

A sample of 100 policies written by the Alfa P & C companies in the State of Alabama was checked against the ALDOI's licensing records, to verify if the agents were appropriately licensed for the P & C Companies. No discrepancies were found within the sample.

### **Advertising and Marketing**

The Company's advertising materials were reviewed for the period covered by the examination. The advertisements consisted of signs, billboards, newspaper advertisements and spot advertisements on radio and television.

The Company's web page ([www.alfains.com](http://www.alfains.com)) was reviewed and found to include the following links: Company's background, product lines, claim information, career opportunities, how to locate an agent or the Alabama Farmers Federation, headlines, and Company contact information.

The Company's advertising was planned and coordinated by Integrated Marketing Communication a subdivision of the Alfa Mutual Insurance Company's marketing division. The cost of advertisement was shared on a proportionate basis with other participating affiliates of the Company and the Alabama Farmers Federation. Company management indicated that the producers are not allowed to create their own advertising and sales material, including internet sites. Producers are required to use Company approved advertising material.

### **Claims Payments Practices**

#### ***Paid Claims***

A sample of one hundred claims was selected from the 2002 – 2006 closed claims register. The population from which the sample was taken included all of the paid claims from each of the P&C companies being examined. The paid claims sample was reviewed with regards to compliance with policy provisions, timeliness of payments, and adequacy of documentation. Other than the items listed below, no noteworthy discrepancies were found within the sample of paid claims. The examiners determined the following:

- Five files could not be located.
- Two claim payment drafts could not be located.

Since the Company could not provide the five files and the two claim payment drafts, the Company did not comply with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

### *Denied and Closed without Payment Claims*

A sample of one hundred claims was selected from a population of 120,941 claims denied during the examination period. The population from which the sample was taken included all of the denied claims from each of the P&C companies being examined. The claims were reviewed to verify compliance with claims payment practices of the Alabama Department of Insurance (ALDOI). The examiners determined the following:

- Two files could not be located.
- Four files did not have denial notifications to the insured, but had a note indicating that the files were closed.
- Two files did not have any correspondence.

Since the two files could not be located and six other files lacked adequate denial correspondence, the Company was not in compliance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

Because six of the eight files did not contain documentation regarding the denial notification, the Company was not in compliance with ALA. ADMIN. CODE 482-1-125-.07 (1) (2003), which states,

“... No insurer shall deny a first party claim on the grounds of a specific policy provision, condition or exclusion unless reference to such provision, condition, or exclusion is included in the denial. The denial may be given to

the first party claimant in writing, verbally or electronically (e-mail). If verbal, the file should clearly indicate the denial and reasons for the denial. If the denial is in writing or electronic (e-mail), the file should contain a copy of the denial letter or e-mail. . . .”

Company management response concerning two of the missing files:

[While we make every effort to retain all claim files, we do acknowledge that one of the two files has not been located at this time. We are continuing to locate this file. One of the two files, with a closed date of 2/26/2002, falls outside the required retention period as required by ALA. ADMIN. CODE §482-1-125-.04 (a), which states:

“This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer’s activities relative to each claim.”]

Company management response concerning the six files with missing correspondence:

[Alfa’s claim Management has reviewed six of the eight files and found no evidence that these claims were denied on the grounds of a specific policy provision, condition or exclusion. Also, the Company’s Best Practices Manual states, “The claim file needs to be documented in such a fashion that the reasoning behind a denial can be clearly understood by other claims professional.”]

The previous examination had also recommended that the Company comply with ALA. CODE § 27-27-29 (a) (1975), and keep complete and accurate records of its claims transactions.

### **Policyholders’ Complaints**

The Company’s complaint register was reviewed in order to verify if all written complaints were logged on the register. Company management indicated that complaints from insurance departments and written complaints received at the home office that allege violation of state or federal laws or of any regulations, directives, or bulletins of the insurance departments are logged on the register. There was one register for the seven Alfa P&C companies combined, which included: 1) The Company, 2) Alfa Mutual Fire Insurance Company, 3) Alfa Mutual General Insurance

Company, 4) Alfa Insurance Corporation, 5) Alfa General Insurance Corporation, 6) Alfa Specialty Insurance Corporation, and 7) Alfa Vision Insurance Corporation.

During the period covered by the examination, 233 complaints were logged on the register against the Alfa P & C companies. The complaint register did not specify which company was the subject of the complaint. Fifty complaint files were requested to determine if the files contained adequate documentation. The examiners determined that the Alfa P & C companies maintained adequate documentation.

The Alabama Department of Insurance adopted the NAIC Market Regulation Handbook, effective May 7, 2007, via ALA. ADMIN. CODE 482-1-097-.07 (2007). According to the handbook, regulated entities should include, but not be limited, to the following information in the complaint register:

- Line of business
- Function (underwriting, marketing and sales, claims, policyholder services or miscellaneous);
- Reason for complaint (underwriting, application, cancellation, rescission, non-renewal).

The handbook also requires that the regulated entity record all written communication expressing a grievance in the regulated entity's complaint register.

### **Privacy Policies and Practices**

The Company's policy is that non-public information involving underwriting, marketing, claims handling, and fraud prevention is not shared with anyone outside the Company except for that sharing allowed by the exceptions in the Gramm-Leach-Bliley Act. The insured receives a Privacy Notice at the point-of-sale, and the Company sends a Privacy Notice to the insured on an annual basis. The Company complied with the privacy requirements of ALA. ADMIN. CODE 482-1-122 (2001).

### **SPECIAL DEPOSITS**

In order to comply with the statutory requirements for doing business in the various jurisdictions, in which it was licensed, the Company had the following securities on deposit with state authorities or pledged under reinsurance contracts at December 31, 2006.

<u>State</u>	<u>Book Value</u>	<u>Fair Value</u>
Alabama	\$1,145,219	\$1,360,968
Georgia	34,697	46,821
Massachusetts	495,667	668,865
North Carolina	297,400	401,319
Virginia	297,401	299,613
Aggregate Other Alien:		
• For Reinsurance with Admiral Insurance	82,150	88,885
• For Reinsurance With American Agriculture Insurance Company	117,357	126,978
<b>Total</b>	<b>\$2,469,891</b>	<b>\$2,993,499</b>

## FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

<u>Year</u>	<u>Gross Premiums Written</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Policyholders' Surplus</u>
2001*	\$693,415,733	\$1,113,238,221	\$378,908,954	\$734,329,267
2002	744,671,175	1,118,562,872	397,894,426	720,668,446
2003	782,544,374	1,220,573,340	417,291,549	803,281,791
2004	762,489,664	1,273,824,047	402,129,062	871,694,985
2005	892,308,745	1,274,412,213	395,026,004	879,386,209
2006*	962,893,513	1,338,597,654	410,199,212	928,398,442

\*Per examination.

Amounts for the remaining years were obtained from Company copies of filed Annual Statements.

## REINSURANCE

### Intercompany Reinsurance Pooling Agreement

This agreement was originally effective August 1, 1987, between the Company and its affiliates: Alfa Mutual Fire Insurance Company (AMF); Alfa Mutual General Insurance Company (AMG); Alfa Insurance Corporation (AIC); and Alfa General Insurance Corporation (AGI). Alfa Specialty Insurance Corporation (ASI) was added

to the pool in 2001. Alfa Vision Insurance Corporation (AVI) was added to the pool in 2005. These participants in the pooling agreement will be referred to as “the affiliates” for the remainder of this discussion. This reinsurance pooling agreement was filed with the Alabama Department of Insurance on July 29, 1987, and was subsequently approved. Pertinent terms of the agreement are as follows:

Initially, the affiliates ceded 100% of their book of business then in-force to the Company and pay the Company their proportionate share of the net unearned premium less commissions at the provisional rate of 20%.

Currently, the affiliates cede 100% of the net liabilities for net premiums written and the Company retains or retrocedes the pooled business in accordance with the following percentages:

Company	Effective January 1, 2001	Effective January 1, 2005
AMI	18	18
AMF	13	13
AMG	3	3
ASI	1	1
AIC	32.5	30
AGI	32.5	30
AVI	<u>N/A</u>	<u>5</u>
TOTAL	<u>100</u>	<u>100</u>

The following percentages are shown below for the Coinsurance Allocations for Catastrophe Losses and Related Expenses for the related years:

Effective January 1, 2002			Effective January 1, 2003		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI AIC	AMI, AMF AMG, ASI		AGI AIC	AMI, AMF AMG, ASI
11.6	65%	35%	12.125	65%	35%
19	0%	100%	19	0%	100%
32	0%	100%	32	0%	100%
43	0%	100%	43	0%	100%
77	0%	100%	77	0%	100%
146	0%	100%	146	0%	100%
198	0%	100%	198	0%	100%
289+	16%	84%	301.5 +	18%	82%

- Cumulative calendar year catastrophe losses and related expenses are in millions.
- AIC and AGI to be allocated equally.

- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC and AGI to be allocated according to this group's relative surplus.

Effective January 1, 2004		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI AIC	AMI, AMF AMG, ASI
Less than or = 14.2	65%	35%
Between 14.2 – 352	0%	100%
Greater than or = 352	18%	82%

- AIC and AGI to be allocated equally.
- AMI, AMF, AMG, and ASI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC and AGI to be allocated according to this group's relative surplus.

Effective January 1, 2005			Effective January 1, 2006		
Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation		Cumulative Calendar Year Catastrophe Losses and Related Expenses (Million)	Coinsurance Allocation	
	AGI, AVI AIC	AMI, AMF AMG, ASI		AGI AVI AIC	AMI, AMF AMG, ASI
Less than or = 17.9	65%	35%	Less than or = 21.2	65%	35%
Between 17.9 – 443.7	0%	100%	Between 21.2 – 525.5	0%	100%
Greater than or = 443.7	19%	81%	Greater than or = 525.5	21%	79%

- AMI, AMF, AMG, ASI, AIC, AGI and AVI to be allocated according to this group's relative pool percentages in effect.
- Catastrophe losses are to be accumulated during each annual calendar period.
- AMI, AMF, AMG, ASI, AIC, AGI and AVI to be allocated according to this group's relative surplus as reported in the preceding year-end annual statement.
- Effective January 1, 2006 - Coinsurance Allocation of AMI to include any coinsurance allocation for ASI (AMI's wholly owned subsidiary).



### Reinsurance Assumed

In addition to business assumed through the intercompany pooling agreement, the Company assumed reinsurance from two mandatory reinsurance pools.

At December 31, 2006, the Company had assumed reinsurance under approximately eleven reinsurance agreements with unaffiliated companies. All were inactive for new business. None of the reserves related to the run-off on the inactive contracts was material at December 31, 2006.

### Reinsurance Ceded

As of December 31, 2006, the Company ceded reinsurance to an affiliate, Alfa Mutual Fire Insurance Company (AMF) via three Intercompany Traditional Excess Catastrophe Reinsurance contracts:

- 1) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective January 1, 2006, whereby the Company cedes 100% of the First and Second Excess Catastrophe Reinsurance as follows:

	First Excess	Second Excess
Company's Retention	\$75,000,000	\$125,000,000
Participation Rate:	54.3%	54.3%
Reinsurer's Per Occurrence Limit (100% of)	\$50,000,000	\$75,000,000
Reinsurer's Term Limit (100% of)	\$100,000,000	\$150,000,000

- 2) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective June 1, 2006, whereby the Company cedes 100% of the Third, Fourth, Fifth, Sixth A and Sixth B Excess Catastrophe Reinsurance, subject to the following:

	Third Excess	Fourth Excess	Fifth Excess	Sixth A Excess	Sixth B Excess
Company's Retention	\$200,000,000	\$300,000,000	\$400,000,000	\$500,000,000	\$525,500,000
Intercompany Placement %	72.25%	96.3%	85.925%	79.555%	79.555%
Participant Rate:	54.3%	54.3%	54.3%	54.3%	46.3%
Reinsurer's Per Occurrence Limit (100% of)	\$100,000,000	\$100,000,000	\$100,000,000	\$25,500,000	\$174,500,000
Term Limit (100% of)	\$200,000,000	\$200,000,000	\$200,000,000	\$51,000,000	\$349,000,000

- 3) Intercompany Traditional Excess Catastrophe Reinsurance Contract, effective June 15, 2006, whereby the Company ceded 100% of the Seventh Excess Catastrophe Reinsurance. The Company's pool participation rate for this layer is 46.3%. The Reinsurer's retention is the first \$700,000,000 of ultimate net loss per occurrence, with a term limit of 80.5% of \$100,000,000.

As of December 31, 2006, the following contracts for ceding reinsurance to non-affiliated companies were applicable to the Company:

*General Reinsurance Corporation*

- Excess of Loss Reinsurance (9138) – effective April 1, 2004, on property business. The Company's retention for the first excess cover was \$500,000 and the second excess cover was \$1,000,000. The limit of liability of the reinsurer will not exceed a total payment of net loss and adjustment expenses combined under the first excess cover of \$1,500,000 or under the second excess of \$3,000,000 all risks involved in one occurrence. This agreement also included excess of loss reinsurance of liability business. The Company's retention was \$500,000 for the first excess cover and \$1,000,000 for the second excess cover. Effective April 1, 2005, the Company's retention increased to \$600,000 on property and liability. Effective July 1, 2006, the Company's retention for the first excess cover increased to \$750,000, on property only, and a third excess cover in the amount of \$2,000,000 for new and renewal policies becoming effective at and after October 1, 2006 was added.
- Quota Share and Excess of Loss Reinsurance of Personal Umbrella Business (B762-03) – effective August 1, 2003, on automobile liability, licensed recreational vehicles, uninsured/underinsured motorists' coverages, business pursuits, employers' liability, personal liability and unlicensed recreational vehicles and watercraft liability. AMI's retention is 5% of the first \$1,000,000 each occurrence. The limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$2,000,000 for youthful operators and \$5,000,000 as respects all other policies, each occurrence.
- Quota Share and Excess of Loss Reinsurance of Farm Personal Umbrella Business (B762-03) – effective August 1, 2003, on automobile liability, licensed recreational vehicles, uninsured/underinsured motorists' coverages, business pursuits, employers' liability, farm liability, personal liability and unlicensed recreational vehicles and watercraft liability. AMI's retention is 5% of the first \$1 million, each occurrence. The limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$2,000,000 for youthful operators and \$5,000,000 as respects all other policies, each occurrence.

- Quota Share and Excess of Loss Reinsurance of Commercial Umbrella Business (B762-03) – effective August 1, 2003, on commercial general liability, comprehensive automobile liability including hired and non-owned auto coverage and uninsured/underinsured motorists' coverages, watercraft liability, employers' liability, and professional liability. AMI's retention is 5% of the first \$1 million, each occurrence. The limit of liability of the Company with respect to any one policy shall be deemed not to exceed \$5,000,000 each occurrence / \$5,000,000 aggregate (where applicable).
- Property Facultative Binding Agreement (174), effective December 1, 2003, on fire, allied lines, inland marine or commercial multiple peril and church risks in Alabama, Georgia or Mississippi. The Company's retention was \$2,500,000 and the maximum amount of reinsurance was \$8,000,000 at 12/31/06.

## ACCOUNTS AND RECORDS

The Company's principal accounting records were maintained on electronic data processing equipment and manually on personnel computers. The Company provides management and operating services to its insurance affiliates under a Management and Operating Agreement. For further review of the agreement, see the caption *Management and Operating Agreement* under the heading HOLDING COMPANY AND AFFILIATES section of this report.

The examiners reviewed the accounts and records maintained by the Company for its cash disbursements of \$25.00 or more. The review indicated the Company's documentation for intercompany balance transfers was not in compliance with ALA. CODE § 27-27-30 (1975). The Company provided copies of the cancelled checks, and vouchers which included the amount of transfer, the payor, and payee. The documentation did not include a description of the consideration for the payment, a description of the services provided, itemization of the expenditures, or a receipt. The documentation is required by ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

### **Internal Accounting Records**

The Company’s internal controls and controls in the information systems were evaluated by observation, by interviewing Company personnel, and by reviewing the NAIC Evaluation of Controls and Information Systems Questionnaires completed by the Company, and the NAIC General Control Procedures completed by the examiners. The Company’s internal controls appeared to be sufficient to safeguard the Company’s assets and to generate adequate records of its business.

### **External Audit and Actuarial**

The Company and its affiliates were audited annually, on a statutory basis. In 2006, the Company and its affiliates were audited by the certified public accounting (CPA) firm of PriceWaterhouseCoopers (PwC), Birmingham, AL; and annually in 2002-2005 by KPMG, Birmingham, AL. The audit reports and workpapers of the external auditors were obtained and utilized as deemed appropriate.

The reserve calculations for the years 2002 - 2005, were certified by Mr. Scott Weinstein, FCAS, MAAA of KPMG. The reserve calculation for year-end 2006 was certified by Mr. Anthony Kellner, FCAS, MAAA of PwC.

### **Record Retention Policy**

The Company’s Record Retention Policy stated that the Company maintains its records as required by law and as long as the records were useful to the Company. Company management also indicated that each department within the Company is responsible for developing a record retention schedule that meets the specific needs of the department. The examination determined that the Company’s record retention policy did not contain specific language as to the actual length or time the records are to be retained in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer’s financial condition may be readily

ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

### **Disaster Recovery Plan**

The NAIC Information System Questionnaire (ISQ) assisted the examiners in determining the strengths and weaknesses within the Company’s IS Department. Based on a review of the ISQ responses and supporting documentation, it was determined the business continuity plan describes senior management’s roles and responsibilities associated with the declaration of an emergency and implementation of the disaster recovery and business continuity plans.

The Company provided a copy of its Disaster Recovery Plan and documentation supporting its testing. The Company’s ISQ responses, Disaster Recovery Plan and supporting documentation were reviewed and it was determined the Company has an adequate and up-to-date plan in place. The plan is reviewed quarterly, and tested annually at an alternate site.

### **Consideration of Fraud**

The examiners utilized the procedures recommended in the NAIC Financial Condition Examiners Handbook in Exhibit M – Consideration of Fraud. The CPA documentation on the fraud risk factors was reviewed and procedures were included during the examination to test the risk factors identified during the planning stages of the examination. Company management was interviewed; management showed an understanding of the fraud risk factors in the Company and has taken action over the years to mitigate the risk.

## **FINANCIAL STATEMENTS**

The Financial Statements included in this report were prepared based on the Company's records, and the valuations and determinations made during the examination for the year ended December 31, 2006. Amounts shown in the comparative statements for the years 2002, 2003, 2004, and 2005, were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

Statement of Assets, Liabilities, Surplus	35 and 36
Summary of Operations	37
Capital and Surplus	38

**THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.**

**ALFA MUTUAL INSURANCE COMPANY**  
**STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**

For the Year Ended December 31, 2006

	Assets	Assets Not Admitted	Net Admitted Assets
<b><u>ASSETS</u></b>			
Bonds	\$179,385,578	\$ 0	\$179,385,578
Stocks:			
Preferred Stock	5,980,300	0	5,980,300
Common Stock (Note 1)	512,030,022	602,025	511,427,997
Properties Occupied by the Company less encumbrances (Note 2)	55,711,339	0	55,711,339
Cash, cash equivalents, and short-term investments (Note 3)	25,792,477	0	25,792,477
Other invested assets	207,432,661	0	207,432,661
Receivables for securities	<u>65,847,230</u>	<u>2,000</u>	<u>65,845,230</u>
Subtotals, cash and invested assets	\$1,052,179,607	\$604,025	\$1,051,575,582
Investment income due and accrued	2,978,238	0	2,978,238
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection (Note 4)	14,896,593	33,590	14,863,003
Deferred premiums, agents' balances and installments booked but deferred and not yet due (Note 4)	19,885,063	6,962	19,878,101
Reinsurance:			
Amounts recoverable from reinsurers	37,476,816	3,785	37,473,031
Funds held by or deposited with reinsured companies	45,958	0	45,958
Guaranty funds receivable or on deposit	140,604	0	140,604
Electronic data processing equipment and Software	27,551,907	27,551,907	0
Furniture and equipment, including health care delivery assets	728,469	728,469	0
Receivables from parent, subsidiaries and Affiliates	41,937,540	3,923	41,933,618
Health care and other amounts receivable	179,662	166,142	13,520
Aggregate write-ins for other than invested Assets	<u>175,270,713</u>	<u>5,574,713</u>	<u>169,696,000</u>
<b>TOTAL</b>	<b><u>\$1,373,271,170</u></b>	<b><u>\$34,673,516</u></b>	<b><u>\$1,338,597,654</u></b>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.  
ALFA MUTUAL INSURANCE COMPANY

# STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS

For the Year Ended December 31, 2006

<b>LIABILITIES:</b>	
Losses	\$75,743,823
Reinsurance payable on paid losses and loss adjustment expenses	15,688,281
Loss adjustment expenses	11,556,631
Commissions payable, contingent commissions and other similar charges	3,315,553
Other expenses (excluding taxes, licenses, and fees)	27,283,653
Taxes, licenses, and fees (excluding federal and foreign income taxes)	621,283
Current federal and foreign income taxes	11,098,587
Net deferred tax liability	95,489,341
Unearned premiums	55,372,110
Advance premium	9,728,486
Dividends declared and unpaid: Policyholders	5,365
Ceded reinsurance premiums payable (net of ceding commissions)	38,837,841
Funds held by company under reinsurance treaties	69,448
Amounts withheld or retained by the Company for the account of others	30,757,215
Remittances and items not allocated	1,087,217
Drafts outstanding	28,885,524
Payable to parent, subsidiaries, and affiliates	1,290,834
Payable for securities	3,265,770
Aggregate write-ins for liabilities	102,250
<b>Total Liabilities</b>	<b>\$ 410,199,212</b>
<b>Surplus and other funds:</b>	
Partnership Capital Commitment	12,584,262
Contractual Commitments	39,689,841
Unassigned funds (surplus)	876,124,339
<b>Surplus as regards policyholders</b>	<b>\$ 928,398,442</b>
<b>TOTAL</b>	<b>\$1,338,597,654</b>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.



**ALFA MUTUAL INSURANCE COMPANY  
SUMMARY OF OPERATIONS**

**For the Years Ended December 31, 2006, 2005, 2004, 2003 and 2002**

	2006	2005	2004	2003	2002
<b>Underwriting Income</b>					
Premiums earned	\$147,265,654	\$143,195,658	120,975,224	114,263,405	108,204,926
Losses incurred	138,856,985	189,544,511	104,425,607	104,825,592	97,676,332
Loss expenses incurred	8,060,594	6,042,144	5,807,985	4,565,820	4,989,061
Other underwriting expenses Incurred	55,128,242	42,179,678	33,567,294	39,615,575	39,265,769
Aggregate write-ins for Underwriting deductions	(442)	(57,712)	(203,136)	106,373	(382,063)
Total underwriting deductions	<u>\$202,045,379</u>	<u>\$237,708,621</u>	<u>\$143,597,750</u>	<u>\$149,113,360</u>	<u>\$141,549,099</u>
Net underwriting gain / (loss)	(54,779,725)	(94,512,963)	(22,622,526)	(34,849,955)	(33,344,173)
<b>Investment Income</b>					
Net investment income earned	35,056,784	39,454,069	40,081,018	33,423,830	56,276,013
Net realized capital gains / (loss)	<u>47,996,008</u>	<u>22,386,562</u>	<u>11,346,471</u>	<u>8,154,840</u>	<u>(2,706,829)</u>
Net investment gain / (loss)	83,052,792	61,840,631	51,427,489	41,578,670	53,569,184
<b>Other Income</b>					
Net gain / (loss) from agents' or premium balances charged off	(369,300)	(66,420)	(62,692)	0	0
Finance and service charges not included in premiums	3,926,371	2,798,435	1,694,010	1,638,598	1,564,043
Aggregate write-ins for miscellaneous income	<u>2,545,958</u>	<u>2,686,306</u>	<u>7,177</u>	<u>(97,385)</u>	<u>(17)</u>
Total other income	6,103,029	5,418,321	1,638,495	1,541,212	1,564,026
Net income before dividends to policyholders, after capital gains tax and before all federal and foreign income tax	34,376,096	(27,254,011)	30,443,458	8,269,927	21,789,037
Dividends to policyholders	<u>12,631,373</u>	<u>0</u>	<u>0</u>	<u>(262)</u>	<u>0</u>
Net income after dividends to policyholders, after capital gains tax and before all federal and foreign income tax	<u>21,744,723</u>	<u>(27,254,011)</u>	<u>30,443,458</u>	<u>8,270,189</u>	<u>21,789,037</u>
Federal and foreign income taxes Incurred	<u>(20,027,879)</u>	<u>(17,749,273)</u>	<u>(5,817,955)</u>	<u>1,436,674</u>	<u>13,325,634</u>
<b>Net Income</b>	<b>\$41,772,602</b>	<b>\$ (9,504,738)</b>	<b>\$36,261,413</b>	<b>\$6,833,515</b>	<b>\$8,463,403</b>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.

**ALFA MUTUAL INSURANCE COMPANY  
CAPITAL AND SURPLUS ACCOUNT**

For the Years Ended December 31, 2006, 2005, 2004, 2003 and 2002

	2006	2005	2004	2003	2002
Surplus as regards policyholders, December 31 prior year	<u>\$879,386,209</u>	<u>\$871,694,985</u>	<u>\$803,281,791</u>	<u>\$720,668,446</u>	<u>\$734,329,266</u>
Net income	\$41,772,602	\$(9,504,738)	\$36,261,413	\$6,833,515	\$8,463,403
Change in net unrealized capital gains or (losses)	2,990,883	2,524,960	29,676,048	60,873,792	(23,778,255)
Change in net deferred income tax	(1,016,671)	8,508,529	12,826,607	12,804,368	3,079,015
Change in non-admitted assets	4,544,397	4,622,114	(11,512,044)	2,082,285	(2,559,053)
Cumulative effect of changes in accounting principles	(972,872)	0	0	0	936,475
Aggregate write-ins for gains and losses in surplus	<u>1,693,895</u>	<u>1,540,359</u>	<u>1,161,170</u>	<u>19,385</u>	<u>197,595</u>
Change in surplus as regards policyholders for the year	<u>\$49,012,234</u>	<u>\$7,691,224</u>	<u>\$68,413,194</u>	<u>\$82,613,345</u>	<u>\$(13,660,820)</u>
Surplus as regards policyholders, December 31 current year	<u>\$928,398,443</u>	<u>\$879,386,209</u>	<u>\$871,694,985</u>	<u>\$803,281,791</u>	<u>\$720,668,446</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN  
THIS REPORT ARE AN INTEGRAL PART THEREOF.

## NOTES TO FINANCIAL STATEMENTS

### Note 1 - Common Stocks

\$511,427,997

The captioned amount is the same as reported in the Company's 2006 Annual Statement.

The Company's *Schedule D – Part 2 – Section 2* of the 2006 Annual Statement reported investments in five Subsidiary Controlled Affiliated (SCA) companies. It was determined that the SUB 2 form filings for two of the SCA companies were last made on May 20, 2003. No filings were made during the years 2004, 2005, and 2006. The fair value of the investments at December 31, 2006, is listed below:

<u>Name</u>	<u>Fair Value</u>
• Alfa Properties, Inc.	\$88,029,581
• Alfa Services Inc.	<u>661,843</u>
<b>Total</b>	<u><b>\$88,691,424</b></u>

The examiners determined that SUB 2 form filings were not made during the years 2004, 2005, and 2006 as required by PART FOUR, Section 8 of the NAIC Purposes and Procedures Manual of the SVO, which states:

“... An insurer makes a SUB 1 filing in order to report the SCA investment to the SVO and to obtain confirmation that the investment is economic and reasonable within the meaning of Part Eight, Section 4(c) of this Manual.

In June of the following year, the insurance company that reported the SCA investment on a SUB 1 form in the previous year is required to file a SUB 2 form. SUB 2 filings are made in order to obtain SVO's opinion as to whether the value claimed by the insurer is approved or disapproved as the value to be reported on the next NAIC Financial Statement Blank. ...”

ALA. ADMIN. CODE 482-1-098-.02 (1994), states:

“(1) All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO. ....

(3) Any security not valued in accordance with this rule shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with Paragraph (1) or (2) of this rule.”

SUB 2 forms for December 31, 2005 and December 31, 2006 for Alfa Properties, Inc. and SUB 2 forms for December 31, 2006 for Alfa Services, Inc. were filed by the Company with the SVO. On December 12, 2007, the SVO valued the securities in accordance with the NAIC valuation procedures relating to the valuation of Common Stocks of SCA.

The SCA investment in Alfa Properties, Inc., was valued at \$83,154,637, which was \$4,874,944 less than the \$88,029,581 reported by the Company in its 2006 Annual Statement. The NAIC SVO requested the Company to adjust the difference in the carrying value of the security in the 2008 Annual Statement. The NAIC SVO letter to the Company dated December 12, 2007, stated:

“Claimed value differs from approved value. Difference is immaterial and should be adjusted in the next Annual Statement.”

Company management indicated that no adjustment was made to the carrying value of the security at December 31, 2007. The Company should comply with the recommendation made by the NAIC SVO.

Since the Company made the necessary Sub – 2 filings, the amount was admitted for the purpose of this examination.

**Note 2 - Real Estate:**

**Properties occupied by the Company**

**\$55,711,399**

The captioned amount is the same as reported in the Company’s 2006 Annual Statement.

The examiners determined that the Company did not have an appraisal for seven of the nine properties occupied by the Company and listed in its Schedule A - Part 1. When completing the Annual Statement annually, if it did not have an appraisal, the Company used December 31 of the reporting year. The appraisal date reported in the 2002 Annual Statement was December 31, 2002; in 2003, the appraisal date was December 31, 2003; in 2004, the appraisal date was December 31, 2004; in 2005, it was December 31, 2005; and in 2006, it was December 31, 2006. This practice does not comply with the NAIC Annual Statement Instructions for completing Schedule A

- Part 1 with regards to column 6, date of last appraisal, which stipulates, "State date of last appraisal."

The Company's Capitalization and Depreciation policy, revised December 22, 2004, states, "Building improvements include items related to the operation and maintenance of a building." The Company's capitalization policy is in conflict with SSAP No. 40, paragraph 14, of the NAIC Accounting Practices and Procedures Manual, which states:

"Expenditures that are necessary to put the asset back into good operating condition or to keep it in good operating condition, shall be charged to expense as incurred. Expenditures that add to or prolong the life of the property shall be added to the cost of the real estate (capitalized) and depreciated over the remaining useful life of the property."

The examiners reviewed the listing of capitalized improvements made during the period under examination. It was determined that kitchen equipment leases and moving expenses for \$92,196 were capitalized during the year 2005. It was noted that subsequently in 2006, the items were expensed. The examiners also found some other items, which were on the listing of capitalized improvements, but did not prolong the life of the property.

The listing of capitalized improvements also consisted of expenses which were less than the \$5,000 minimum stipulated in the Company's Capitalization and Depreciation Policy. Hence, the Company did not comply with its own capitalization policy, which states:

"The Company will capitalize all personal property, real property and prepaid expenses when the cost exceeds \$5,000. Personal property, real property and prepaid expenses less than \$5,000 will be expensed as incurred."

**Note 3 – Cash, cash equivalents and  
short-term investments**

**\$25,792,477**

The captioned amount is the same as reported by the Company in its 2006 Annual Statement.

On *Schedule - E Part 1* - Cash, the Company reported \$7,269,391 in deposits as shown in the following table:

<u>Banks</u>	<u>Amount</u>
• AmSouth Bank	\$6,834,737
• Compass Bank	170,114
• Wachovia Bank	13,854
• Deposits in 119 depositories	<u>250,687</u>
<u>Total</u>	<u>\$7,269,392</u>

### AmSouth Bank

On *Schedule E – Part 1 – Cash*, the balance held at AmSouth Bank was reported as \$6,834,737. The amount included deposits held in six accounts with AmSouth Bank and one account held with Wachovia Bank. The general ledger balances in four of the six AmSouth Bank accounts were in excess of \$100,000 or less than (\$100,000). The four amounts according to the general ledger and bank reconciliation statements were: 1) \$199,280, 2) \$12,496,841, 3) (\$816,150), and 4) (\$7,871,333). As indicated above, the Company included the deposits held at Wachovia Bank for \$2,803,596 with the total deposited with AmSouth bank.

The examiners determined that the bank balances were not reported in accordance with the guidance provided by the NAIC Annual Statement Instructions, which state:

“Report separately all deposits in excess of \$100,000 or less than (\$100,000). Deposits not exceeding \$100,000 or not less than (\$100,000) in federally insured depositories may be combined.”

### Compass Bank

On *Schedule E – Part 1 – Cash*, the balance held at Compass Bank was reported as \$170,114. The balance included deposits held in two Compass Bank accounts. The amounts were 1) \$337,178, and 2) \$(242,297). The examiners determined that the bank balances were appropriately reported.

### Wachovia Bank

The Wachovia Bank balance of \$13,834, reported in *Schedule E – Part 1 – Cash*, was comprised of deposits held at two banks: Wachovia Bank and Whitney Bank. A review of the accounts and records indicated that the Company inappropriately included \$2,803,596, held at Wachovia Bank as a deposit held at AmSouth Bank. (See the commentary on AmSouth Bank above.)

<b><u>Note 4 – Uncollected Premiums and agents’ balances in the course of collection</u></b>	<b><u>\$14,863,003</u></b>
<b><u>Deferred premiums, agents’ balances and installments booked but deferred and not yet due</u></b>	<b><u>\$19,878,101</u></b>

The captioned \$14,863,003 is the same as reported by the Company in its 2006 Annual Statement, but \$1,188,235 less than that determined by the examination. The captioned \$19,878,101 is the same as reported by the Company in its 2006 annual Statement, but \$1,188,235 more than that determined by the examination.

The examination determined that the Company recorded certain premiums due under *Deferred premiums and agents’ balances and installments booked but deferred and not yet due*. Premiums due are recorded under *Uncollected premiums and agents’ balances in the course of collection*, in accordance with the guidance provided by the NAIC Annual Statements Instructions, which state:

“Line 13.1 – Uncollected premiums and Agents’ Balances in Course of Collection.

Include: Direct and group billed uncollected premiums. Amounts collected but not yet remitted to home office.”

## **CONTINGENT LIABILITIES AND PENDING LITIGATION**

The examination for contingent liabilities and pending litigation included review of the Company’s Annual Statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of the accounts for unrecorded items. No unreported contingent liabilities were noted, and all litigation pending against the Company, at December 31, 2006, appeared to be within the ordinary course of its business.

The Company’s Chief Executive Officer and its Chief Financial Officer executed a letter of representation, attesting to the non-existence of unreported liabilities and contingencies as of December 31, 2006.

## COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regards to the Company's compliance with recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the recommendations contained in the immediately preceding Report on Examination with the exception of the item listed below.

### Claims Payment and Practices

The previous examination had noted that the Company did not provide five claims files out of forty-seven files taken from the closed and closed without payment listing, and recommended that the Company comply with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

The Company did not comply with the recommendation made in the prior Report on Examination. See the caption Claims Payments Practices under the heading MARKET CONDUCT ACTIVITIES.

## COMMENTS AND RECOMMENDATIONS

### Conflict of Interest – Page 9

It is recommended that the Company maintain evidence of its conflict of interest statements signed by each officer, director and other key personnel as required by the Company's "Principles of Business Conduct" policy and the GENERAL INTERROGATORIES of the NAIC Annual Statement Instructions.

### Holding Company Registration and Reporting – Page 9

It is recommended that the Company include all required disclosures of transactions between affiliated companies in its holding Company registration



statements and amendments as required by ALA. ADMIN. CODE 482-1-055 (1994), which states:

**“Form B – Item 5. Transactions and Agreements**

Briefly describe the following agreements in force, and transactions currently outstanding or which have occurred during the last calendar year between the registrant and its affiliates . . . (a) Loans, other investments, or purchases, sales or exchanges of securities of the affiliates by the Registrant or of the Registrant by its affiliates. . . .”

**It is recommended** that the Company file an Amendment to Form B when a material change to the information provided in the annual registration statement has taken place as required by ADMIN. CODE 482-1-055-.15 (1) (1994), which states:

“An Amendment to Form B shall be filed within fifteen (15) days after the end of any month in which there is a material change to the information provided in the annual registration statement.”

**Monthly Billing Service Agreement – Page 15**

**It is recommended** that the Company file all related parties’ contracts with the commissioner for approval before entering into transactions under the contract and comply with ALA. CODE § 27-29-5 (b) (1975), which states:

“The following transactions involving a domestic insurer and any person in its holding company system may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto, or such shorter period as the commissioner may permit, and the commissioner has not disapproved it within that period. . . .

(4) All management agreements, service contracts, and all cost-sharing arrangements; and. . . .”

**Section 1033 of Title 18 of the U.S. Code – Page 19**

**It is recommended** that the Company ask potential employees about all felony convictions on its employment application if it is to be used in the screening process

to ensure prohibited persons under the law are not hired, in accordance with ALA. ADMIN. CODE 482-1-121 (2003), which states:

“... The Act contains no grandfather provision for persons already transacting the business of insurance. The Act contains no automatic waivers for individuals who may possess a state insurance license. Further, there is no time limitation on how far back the felony conviction that triggers the prohibited person status may have occurred. . . .”

**It is recommended** that the Company create a policy that ensures those authorized to act on its behalf continue to meet the requirements of Section 1033 of Title 18 of the U.S. CODE, and ALA. ADMIN. CODE 482-1-121 (2003), which states:

“... Insurance companies, as well as persons employing anyone to conduct the business of insurance may be in violation of this statute if they willfully permit participation by a prohibited person, including persons who are already employed or being considered for employment. Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statute has occurred. . . .”

### **Territory – Page 20**

**It is recommended** that the Company complete *Schedule T – Exhibit of Premiums Written* appropriately. Specifically, it should not indicate that it is licensed to do business in the State of Tennessee, if the Certificate of Authority to do business is not obtained.

### **Claims Payments Practices – Page 22**

**It is recommended** that the Company maintain complete records of closed claims, including the five missing files, in accordance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

**It is recommended** that the Company maintain complete records of the denied and closed without payment claims, including the missing files, in accordance with ALA. CODE § 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

**It is recommended** that the Company maintains adequate records of the denied and closed without payment claims and retain copies of the denial letter in each file, including the six files determined to lack adequate documentation, as required by ALA. ADMIN. CODE 482-1-125-.07 (2003), which states:

“... No insurer shall deny a first party claim on the grounds of a specific policy provision, condition or exclusion unless reference to such provision, condition, or exclusion is included in the denial. The denial may be given to the first party claimant in writing, verbally or electronically (e-mail). If verbal, the file should clearly indicate the denial and reasons for the denial. If the denial is in writing or electronic (e-mail), the file should contain a copy of the denial letter or e-mail. ...”

#### **Policyholders' Complaints – Page 24**

**It is recommended** that the Company record all written communication primarily expressing a grievance in the company's complaint register. The recommendation is effective May 7, 2007, when the Alabama Department of Insurance adopted the NAIC Market Regulation Handbook.

**It is recommended** that the company log the function and reasons for complaints in its complaint register. The recommendation is effective May 7, 2007, when the Alabama Department of Insurance adopted the NAIC Market Regulation Handbook.

#### **Accounts and Records – Page 31**

**It is recommended** that the Company maintain the required supporting documentation for all disbursements exceeding \$25.00, including intercompany balance transfers, in accordance with ALA. CODE § 27-27-30 (1975), which states:

“(a) No insurer shall make any disbursement of \$25.00 or more unless evidenced by a voucher or other document correctly describing the consideration for the payment and support by a check or receipt endorsed or signed by, or on behalf of, the person receiving the money.

(b) If the disbursement is for services and reimbursement, the voucher or other document, or some other writing referred to therein, shall describe the services and itemize the expenditures. . . .”

### **Record Retention Policy – Page 32**

**It is recommended** that the Company’s record retention policy indicate that all records should be maintained for no less than five years in accordance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer . . . or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer’s financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

### **Common Stocks – Page 39**

**It is recommended** that the Company file SUB 2 forms for all SCA investments if the Company decides to admit such investments in accordance with the guidance provided by PART FOUR, Section 8 of the NAIC Purposes and Procedures Manual of the SVO, which states:

“. . . An insurer makes a SUB 1 filing in order to report the SCA investment to the SVO and to obtain confirmation that the investment is economic and reasonable within the meaning of Part Eight, Section 4(c) of this Manual.

In June of the following year, the insurance company that reported the SCA investment on a SUB 1 form in the previous year is required to file a SUB 2 form. SUB 2 filings are made in order to obtain SVO’s opinion as to whether the value claimed by the insurer is approved or disapproved as the value to be reported on the next NAIC Financial Statement Blank. . . .”

Any investments that are not filed in accordance with the guidance provided by the NAIC Purposes and Procedures Manual of the SVO must not be admitted in accordance with the guidance provided by ALA. ADMIN. CODE 482-1-098-.02 (1994), which states:

“(1) All securities owned by an insurer shall be valued in accordance with those standards promulgated by the NAIC Securities Valuation Office (SVO). Any security owned by an insurer that has not been valued by the SVO shall be submitted to the SVO for valuation in accordance with the procedures of the SVO. . . .

(3) Any security not valued in accordance with this rule shall be carried as a non-admitted asset on all financial statements of the insurer until such time as the insurer has complied with Paragraph (1) or (2) of this rule.”

**It is recommended** that the Company adjust the carrying value of the SCA investment as requested by the NAIC SVO.

#### **Real Estate: Property occupied by Company – Page 40**

**It is recommended** that the Company comply with the NAIC Annual Statement Instructions for completing Schedule A - Part 1 with regards to column 6, date of last appraisal, which stipulates, “State date of last appraisal.”

**It is recommended** that the Company review and amend its capitalization policy so that it provides guidelines for capitalization and depreciation practices that comply with SSAP No. 40, paragraph 14, of the NAIC Accounting Practices and Procedures Manual, which states:

“Expenditures that are necessary to put the asset back into good operating condition or to keep it in good operating condition, shall be charged to expense as incurred. . . .”

#### **Cash and short-term investments - Page 41**

**It is recommended** that the Company report all deposits in excess of \$100,000 or less than (\$100,000) separately as required by the NAIC Annual Statement Instructions, which state:

“Report separately all deposits in excess of \$100,000 or less than (\$100,000). Deposits not exceeding \$100,000 or not less than (\$100,000) in federally insured depositories may be combined.”

**Uncollected premiums and agents’ balances in the course of collection – Page 43**

**Deferred Premiums, agents’ balances and installments booked but deferred and not yet due – Page 43**

It is recommended that the Company record all due and uncollected premiums on *Uncollected premiums and agents’ balances in the Course of collection* in accordance with the guidance provided by the NAIC Annual Statement Instructions, which state:

“Line 13.1 – Uncollected premiums and agents’ balances in course of collection.

Include: Direct and group billed uncollected premiums. Amounts collected but not yet remitted to home office.”

## **SUBSEQUENT EVENTS**

The review of events subsequent to December 31, 2006, and up to the date of this report included: review of the March 31, 2007, June 30, 2007, and September 30, 2007, Quarterly Statements; 2) review of the December 31, 2007 Annual Statement; and 3) general review of the cash disbursements/receipts transactions that might potentially have a material impact on the Company’s continued operations and/or financial conditions. In addition, the examiners inquired of management regarding any significant subsequent events. There were no significant subsequent events other than those discussed below.

### **Privatization of Alfa Corporation**

On April 15, 2008, Alfa Mutual Insurance Company (AMI) and Alfa Mutual Fire Insurance Company (AMF) completed a merger transaction (the Merger) in which they acquired the shares of Alfa Corporation (AC) not previously owned by them. As a result of the transaction, AC became a wholly owned subsidiary of AMI (65%) and AMF (35%). Each share of common stock of AC (other than shares owned by AMI, AMF, AC, and its wholly owned subsidiaries, and holders of shares subject to certain company awards) was cancelled and converted into the right to receive \$22.00 in cash, without interest.

Also, as a result of the Merger, AC's common stock ceased to trade on the Nasdaq Global Select Market as of the close of trading on April 15, 2008, and the registration of AC's common stock under the Securities Exchange Act of 1934, as amended, was terminated.

### **Contingencies**

Subsequent to the end of the second quarter 2007, and following the initial announcement of the proposed Merger, certain purported class action lawsuits were brought on behalf of the public stockholders of AC in the Delaware Court of Chancery and in the Circuit Court of Montgomery County, Alabama. On April 14, 2008, the Circuit Court of Montgomery County, Alabama, formally approved the settlement reached by the parties to the aforementioned class action lawsuits.

In addition, on November 9, 2007, a policyholder of AMI filed a purported class action against AMI in the Circuit Court of Macon County, Alabama, also relating to the Merger. The policyholder subsequently elected to dismiss the class action claims. Also, on November 21, 2007, certain policyholders of AMI, AMF, and AMG filed a purported class action and derivative action against AMI, AMF, AMG, AC, and certain of their officers and directors in the Circuit Court of Walker County, Alabama. On February 23, 2008, counsel for the parties in the Walker County action entered into a Memorandum of Understanding to settle such action, subject to approval of the court. On March 4, 2008, the Walker County court conditionally approved the settlement and set a final approval hearing for May 28, 2008.

### **Pooling Agreement**

On January 1, 2007, the pooling agreement was amended to add Alfa Alliance Insurance Corporation (AAI). Effective April 16, 2008, the pooling agreement was amended to change the pool participation percentages.

## CONCLUSION

In concluding this Report on Examination, as of December 31, 2006, of *ALFA MUTUAL INSURANCE COMPANY*, acknowledgment is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Jerry Hyche, Charles Turner, Toni Bean, Jennifer Haskell, Mora Perkins, Theo Goodin, Examiners, Frank Fricks, CFE, AIE, Examiner, with Insurance Logic and Matthew Merlino, FCAS, MAAA, FCA and Suejeudi Buehler, FCAS, MAAA, Consulting Actuarial Examiners, both with Merlino & Associates, Inc.; all representing the Alabama Department of Insurance, participated in this examination of Alfa Mutual Insurance Company.

Respectfully submitted,



Blase Francis Abreo, CFE  
Examiner-in-Charge  
State of Alabama  
Department of Insurance